

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: O'Connell Analyst: Kristina E. North Bill Number: SB 1647  
Related Bills: See Legislative History Telephone: 845-6978 Amended Date: June 15, 2000  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** 2000 Natural Heritage Preservation Tax Credit Act

### SUMMARY OF BILL

This bill would enact the Natural Heritage Preservation Tax Credit Act of 2000 within the Public Resources Code (PRC) and would establish tax credits within the Revenue and Taxation Code (R&TC).

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&TCL), this bill would allow a tax credit to taxpayers who donate real property to the state, approved local governments, or approved nonprofit organizations designated by the state or local government. The amount of tax credit would equal 55% of the fair market value (FMV) of the qualified contribution that has been approved for acceptance by the Wildlife Conservation Board.

This analysis addresses the bill's provisions relating to the PRC only as they pertain to the tax credits.

### SUMMARY OF AMENDMENT

The June 15, 2000, amendment added numerous coauthors to the bill.

The June 14, 2000, amendment deleted legislative intent provisions relating to the Department of Corrections and added the provisions discussed in this analysis.

### EFFECTIVE DATE

As an urgency statute, this bill would take effect immediately and specifies it would apply to a qualified contribution made on or after January 1, 2000, and before December 31, 2005.

### LEGISLATIVE HISTORY

**SB 680** (1999 - held in Assembly Appropriations), **SB 2080** (1998 - failed passage in Assembly Appropriations), **SB 87** (1997 - failed passage by the house of origin by January 31 of second year of session) would have established the California Land and Water Conservation Act within the PRC and would have established tax credits within the R&TC similar to those proposed by this bill.

#### Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

#### Department Director

#### Date

Alan Hunter for GHG

7/27/00

### **SPECIFIC FINDINGS**

**Current federal and state tax laws** provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child and dependent care credits) or to influence business practices and decisions or achieve social goals. Credits generally are based on a percentage of tax expenditures by the taxpayer. Currently, no existing federal and state laws provide income tax credits for the contribution of property to state or local governments. Additionally, no federal or state laws provide a tax credit for up to 55% of the value of property without regard to the original cost or current tax basis of such property to the taxpayer.

Under **current federal and California state laws**, contributions of property qualify as charitable contributions if the property is contributed to or for the use of qualified organizations (public, private, or governmental) as follows:

?? For corporations, **existing federal and state laws** allow a deduction for charitable contributions limited to 10% of the taxpayer's net income (except as specified).

Contributions in excess of 10% may be carried over to the five succeeding taxable or income years. Under state law, the amount of a contribution is limited to a taxpayer's basis in the property contributed.

?? For individuals, both **federal and state laws** allow a deduction for charitable contributions. The amount generally deductible for a contribution of appreciated real property (normally capital gain property) is equal to the FMV of the property on the date of contribution. For contributions to certain types of charitable organizations, including governmental units, the allowable deduction is limited to 50% of the taxpayer's adjusted gross income (AGI). However, for other types of charitable organizations, the deduction may be limited to 30% of the taxpayer's AGI. If the charitable contribution amount exceeds 50% (or 30%) of the taxpayer's AGI, the taxpayer may carry over the excess amount up to five years.

Generally, a taxpayer is denied a charitable deduction of rent-free use of property and other nontrust gifts where less than the taxpayer's entire interest in the property is contributed, except for 1) a contribution of an undivided portion of a taxpayer's entire interest in property (e.g., a one-quarter fee interest in property); 2) a contribution of a remainder interest in a personal residence or farm; 3) a qualified conservation contribution; and 4) a charitable deduction that would have been allowed had the interest been transferred in trust.

For a charitable gift of ordinary income-type property, the amount considered contributed (the property's FMV) must be reduced by the amount of ordinary income or short-term capital gain that would have been recognized if the property had been sold by the donor for its FMV.

Ordinary income-type property is property, such as inventory, that would have resulted in some amount of gain, other than long-term capital gain, if sold at its FMV on the date it was contributed.

Under the PRC, **this bill** would establish the Natural Heritage Preservation Tax Credit Act of 2000, to encourage donations of land to the state, local governments, or designated nonprofit organizations.

**This bill** would define a number of terms. The definitions below are provided to assist in reading the remainder of the analysis:

~~///~~ "board" as the Wildlife Conservation Board;

~~///~~ "department" as any statutorily created entity within the Resources Agency;

~~///~~ "designated nonprofit organization" as a nonprofit organization qualified under federal law with a principal purpose of the conservation of land and water resources and designed by a local government or a department to accept property pursuant to this credit. To be eligible for this credit, the nonprofit organization must have experience in land conservation;

~~///~~ "donee" as 1) a department to which a donor has applied to donate qualified property; 2) a local government that has filed a joint application with a donor requesting approval of a donation of property to that local government; or 3) a designated nonprofit organization;

~~///~~ "donor" as a property owner who donates or submits an application to donate property pursuant to this program;

~~///~~ "final approval" or "approval for acceptance" as the Wildlife Conservation Board's approval to grant a tax credit for a donation of qualified property pursuant to this program;

~~///~~ "local government" as any city, county, city and county, special district, or any district defined in the PRC or any joint powers authority made up of those entities, with or without the inclusion of state agencies;

~~///~~ "program" as the National Heritage Preservation Tax Credit Program;

~~///~~ "property" as any real property, and any perpetual interest therein, including land, conservation easements, land containing water rights, and water rights; and

~~///~~ "Secretary" as the Secretary of the Resources Agency.

**This bill** would require that each application for contribution meet the federal charitable contribution deduction provisions. The donor must certify the property satisfies the requirements for a qualified contribution. If the contribution is approved by the Board, the contributor of the property may receive a credit equal to 55% of the property's FMV.

**This bill** would require the Board to provide an annual listing to the Joint Legislative Budget Committee and FTB containing certain information about each donation.

**This bill** would specify that no more than a total of \$100 million in tax credits may be awarded. The tax credits may be awarded in fiscal years 2000/2001, 2001/2002, 2002/2003, 2003/2004, and 2004/2005, and not subsequently thereafter without further statutory authorization.

Under the PITL and the B&CTL, **this bill** would allow donors a tax credit equal to 55% of the FMV of the qualified contribution that has been approved for acceptance by the Board.

**This bill** would specify that in the case of any pass-through entity (e.g., partnership, S corporation or limited liability company treated as a partnership for tax purposes), the FMV of the qualified contribution would be passed through to the partners or shareholders of the pass-through entity in accordance with their interest in the entity as of the date of the qualified contribution.

Under both the PITL and the B&CTL, this credit could reduce regular tax below tentative minimum tax.

Any excess credit may be carried forward for eight years, until the credit amount is exhausted.

This credit would be in lieu of any other state credit or deduction that the taxpayer would otherwise be allowed for the contributed property or interest therein.

### **Policy Considerations**

This bill would provide a credit for donating land and/or water rights equal to 55% of the value of the property, making a land contribution potentially six to eight times more valuable than any other kind of donation. Additionally, in combination with the federal deduction for a charitable contribution, this credit could provide some taxpayers with tax benefits of almost 95% of the value of the donated property. However, the greater value of this incentive appears consistent with the intent of providing a major inducement for land owners to donate property for conservation purposes and to indirectly use federal dollars for part of the costs.

Generally, the amount of the charitable contribution of property must be reduced by an amount equal to the FMV of any property interests or any other consideration the taxpayer may have received in exchange for the donated property. However, this bill does not provide for such a reduction, thus potentially providing the taxpayer with an unintended double benefit for the same property.

### **Implementation Considerations**

The PRC specifies that the tax credits may be awarded in fiscal years beginning 2000/2001 through 2004/2005. However, the R&TC specifies that the qualified contribution may be made on or after January 1, 2000, and prior to December 30, 2005. The 2004/2005 fiscal year ends on June 30, 2005, six months prior to the last day on which a qualified contribution could be made pursuant to the R&TC. To eliminate potential confusion, the author's intent should be clarified.

The PRC uses the term "qualified property," but does not define it, while the R&TC uses "qualified contribution" and defines it by reference to the PRC. "Qualified property" should be defined under the PRC for clarity.

The actual credit language allows taxpayers a credit equal in amount to "55% of the FMV of any qualified contribution." The term "FMV" is not defined under either the PRC or the R&TC. Also, the contribution procedure under the PRC requires the Board to annually provide a list of taxpayers who qualify for the credit and the credit amount. To eliminate the potential for disputes between the department and taxpayers, the R&TC credit language should eliminate the reference to FMV and instead directly tie the allowable credit amount for each taxpayer to the amount certified by the Wildlife Conservation Board, with "FMV" explicitly defined in the PRC. Otherwise, in circumstances where a taxpayer obtains an appraisal of FMV that differs from that assumed by the Secretary in certifying a credit amount, the department may be unable to limit a particular taxpayer's actual credit to the amount certified under the procedure set forth in the PRC. This may further result in the Board being unable to assure it certifies no more than \$100 million in aggregate contributions under this bill.

## **FISCAL IMPACT**

### **Departmental Costs**

With the resolution of the implementation considerations, this bill should not significantly impact the department's costs.

### **Tax Revenue Estimate**

This bill is estimated to create revenue losses under the PITL and the B&CTL as shown in the following table. For this analysis, it was assumed that the property donated must be located in California. This bill limits the amount of credits that may be awarded over a five-year period to \$100 million beginning with fiscal year 2000/2001.

Fiscal Year Cash Flow Impact Effective January 1, 2000 \$ Millions*					
Assumption	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005
\$35 Million in Donated Property per Year	-\$14	-\$19	-\$19	-\$19	\$19

\*Rounded

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

### **Tax Revenue Discussion**

The revenue impact for this bill is determined by the value of property that might be donated in any given year and the tax liabilities of donors for applying tax credits. For this revenue estimate, it is assumed that the maximum allocation of credits will be substantially reached by the fifth fiscal year.

This estimate was developed in the following steps. First, the total FMV of donated property was assumed at \$35 million per year. Second, the amount of credit is 55% of the FMV of the donated property. Third, the contributors would be able to use 75% of the qualified credit amount each year, with unused carryover credits applied in the following year. It is assumed that many taxpayers donating property under the provisions of this bill would have held the property for long periods and would not have sold or donated the property except for combined incentives provided by this bill and federal law. Revenue losses were adjusted to account for current law gains or contributions that would have otherwise been reported for the property.

### **BOARD POSITION**

Pending.

